

CREDIT OPINION

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Analyst Contacts

Nisha Rajan +1.212.553.1978
Analyst
nisha.rajan@moody's.com

Lauren Von Bargaen +1.212.553.4491
AVP-Analyst
lauren.vonbargaen@moody's.com

Leonard Jones +1.212.553.3806
MD-Public Finance
leonard.jones@moody's.com

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Japan 81-3-5408-4100
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Howard (County of) MD

Update to credit analysis

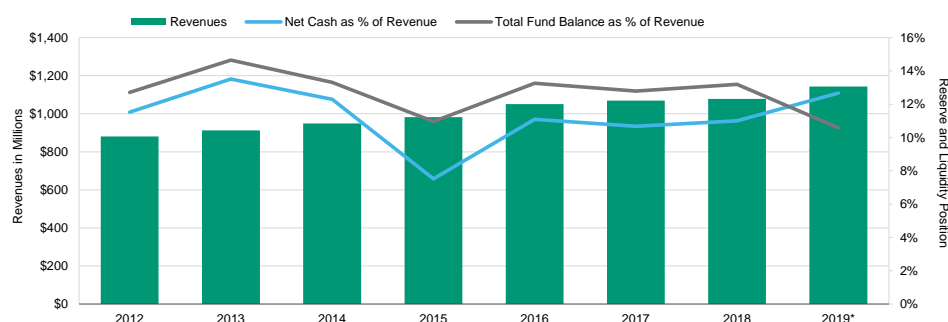
Summary

[Howard County](#) (Aaa stable) benefits from its proximity to the Baltimore-Washington metro area and Fort Meade, and is experiencing moderate economic and employment growth. As a result of increasing development, the county's revenue base is growing, which will support its adequate financial position. The county has historically maintained reserve levels below the Aaa-median, however, due to strong budgeting practices and adherence to formal fiscal policies, its financial position is likely to remain stable.

As business activity and population increase, additional infrastructure investment, particularly for the schools, general county facilities, water, and wastewater utilities is becoming increasingly important. Consequently, because of management's plans to address capital needs with additional debt, Howard County's debt burden will increase.

Exhibit 1

Historically Stable Financial Position Fiscal 2013-2019



*Fiscal 2019 figures are preliminary
Source: Howard County, MD

Credit strengths

- » Large tax base with strong institutional presence and proximity to the Baltimore-Washington metro area
- » Above average wealth and income levels
- » Management team practices conservative budgeting and maintains formal fiscal policies

Credit challenges

- » Reserve levels markedly below the Aaa median

- » Reliance on economically sensitive revenues
- » Growing debt burden
- » Employment closely linked to US government

Rating outlook

The stable outlook reflects the likelihood that the county's financial position will remain sound given management's adherence to formal fiscal policies. Any deviation from these projections or any additional declines in reserves going forward could result in negative credit pressure. The outlook also reflects future growth in the county's base given ongoing commercial and residential development spurred by proximity to the District of Columbia (Aaa stable) and the institutional presence of Fort Meade, which employs approximately 15,000 Howard County residents.

Factors that could lead to an upgrade

- » Not applicable

Factors that could lead to a downgrade

- » Declines in general fund reserves and liquidity
- » Tax base erosion
- » Material increase in debt burden resulting in strained financial position
- » Downgrade of the U.S government's Aaa rating

Key indicators

Exhibit 2

Howard (County of) MD	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value (\$000)	\$44,552,141	\$45,731,164	\$47,641,613	\$49,626,809	\$51,518,005
Population	299,269	304,115	308,447	312,495	321,113
Full Value Per Capita	\$148,870	\$150,375	\$154,456	\$158,808	\$160,436
Median Family Income (% of US Median)	197.8%	194.7%	194.0%	190.9%	190.9%
Finances					
Operating Revenue (\$000)	\$926,845	\$958,738	\$1,052,250	\$1,035,960	\$1,070,909
Fund Balance (\$000)	\$126,274	\$99,548	\$131,497	\$127,649	\$137,266
Cash Balance (\$000)	\$116,650	\$73,825	\$118,281	\$116,288	\$127,055
Fund Balance as a % of Revenues	13.6%	10.4%	12.5%	12.3%	12.8%
Cash Balance as a % of Revenues	12.6%	7.7%	11.2%	11.2%	11.9%
Debt/Pensions					
Net Direct Debt (\$000)	\$1,064,000	\$1,083,433	\$1,142,887	\$1,192,690	\$1,294,175
3-Year Average of Moody's ANPL (\$000)	\$731,654	\$755,659	\$680,139	\$687,858	\$772,514
Net Direct Debt / Full Value (%)	2.4%	2.4%	2.4%	2.4%	2.5%
Net Direct Debt / Operating Revenues (x)	1.1x	1.1x	1.1x	1.2x	1.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.6%	1.7%	1.4%	1.4%	1.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.8x	0.8x	0.6x	0.7x	0.7x

Source: Howard County, MD & Moody's Investors Service

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Profile

Howard County is located between the [City of Baltimore](#) (Aa2 stable) and the District of Columbia and has a population of approximately 321,000.

Detailed credit considerations

Economy and tax base: strategically located tax base with moderate growth; stability from significant institutional and military presence

Howard County's tax base will experience moderate growth because of economic expansion and diversification related to the presence of Fort Meade, as well as its favorable proximity to the Baltimore-Washington metropolitan area. The county's full value increased 3.8% in fiscal 2018 to reach \$51.5 billion, and the five year compound annual growth rate was 3.1%. The statewide requirement to phase in reassessment-related tax base growth over a three-year period helps to balance growth in the county. Additionally, the homestead tax credit, which limits the county's ability to capture homestead appreciation for annual tax levy purposes to 5%, allows pent up growth to smooth tax base levels during periods of declines or stagnation. The county's full value is comparable to the national Aaa-median of \$50.2 billion. Future growth will be driven by continued residential, commercial, and industrial developments throughout the county.

Fort Meade, the state's largest employer and second largest army installation within the US, is located less than two miles from the county line in adjacent [Anne Arundel County](#) (Aa1 stable). The fort currently employs approximately 55,000 employees (15,000 within the county), and tenant organizations include U.S. Cyber Command and the National Security Agency (NSA). Due to this proximity, Howard County benefits from capital investment and economic growth. Current expansion activity at the Fort, primarily roadway and barracks projects, total \$344 million (about 42% funded) and will likely add 3,500 jobs between fiscal 2019 and 2024. The East (Cyber) Campus at Fort Meade is also planning a \$1.8 billion expansion, and funding sources are currently being determined. The county also provides up to five million gallons per day of reclaimed water to cool the supercomputers on Fort Meade's campus, which began in fiscal 2016.

Construction activity remains strong, with ongoing mixed use developments at Oxford Square and Maple Lawn, both of which are adding retail, office and residential space, as well as a 416 unit apartment complex near the Savage Commuter Rail Station, and a 160 unit apartment complex at Little Patuxent. In addition to a twenty year redevelopment plan in downtown Columbia, the county also recently launched a Gateway Innovation Center with the Howard County Economic Development Authority to serve as a technology-focused business incubator, which will occupy 50,000 square feet. The Maryland Department of Assessments and Taxation reports an increase in commercial property tax growth of approximately 2% in fiscal 2018 to just over \$8.4 billion in Howard County.

The county's low unemployment rate of 3.2% in January 2019, below both the state (4.3%) and national (4.4%) levels, reflects a strong and stable underlying local economy. Resident wealth levels are strong, with 2017 median family income of \$135,226 (191% of US and 142% of MD) representing the highest in the state. Full value per capita at \$160,436 is also above average and surpasses the national Aaa-median of \$107,389.

Financial operations and reserves: sound albeit below average reserve levels to remain stable given sound management practices and policies

The county's financial position will remain sound, but narrow relative to other similarly-rated counties, due to adherence to fiscal policies, active management practices, and long-term financial forecasting. Overall, the county experienced an increase in total general fund reserves to \$142.2 million (13.2% of general fund revenues) in fiscal 2018 from a low of \$71.8 million (9% of general fund revenues) in fiscal 2010. This improvement is attributable to conservative budgeting both on the revenue (primarily related to positive income and property tax performance) and expenditure side.

The county finished fiscal 2018 with a \$1.3 million general fund operating surplus after transfers in, and utilized \$2.3 million in reserves instead of a planned use of \$11.9 million in reserves in the revised budget. Revenues and expenditures both surpassed budgetary expectations by approximately \$2.4 million and \$7.2 million, respectively. The county's largest revenue source is property taxes (49.5% of fiscal 2018 revenues), followed by income taxes (41.2%). The county maintains a stabilization "rainy day fund" in the general fund equal to \$71.3 million, or 7% of general fund revenues in fiscal 2018. The county has never utilized funds from this reserve, which would require County Council approval.

The adopted fiscal 2019 budget maintains the property tax rate at 1.014 cents per \$100 of assessed valuation and the local income tax rate of 3.2%, the maximum level permitted under state law. The estimated budget represents a 4.4% increase over the prior year, and anticipates a slight general fund surplus. The capital budget reflects \$147 million for projects in fiscal 2019. The proposed fiscal 2020 budget reflects a 2.7% increase over fiscal 2019 and is anticipated to be balanced.

Going forward, we will monitor the county's ability to meet projections and build reserves to levels more in line with the current rating category (median for Aaa Maryland counties: 15.9% of general fund revenues; median for Aaa national counties: 35.2% of General Fund revenues). Declines in reserves will likely result in negative credit pressure.

LIQUIDITY

The county's general fund cash position increased in fiscal 2018 to \$118.4 million (11% of revenues) from \$114.1 million (10.7% of revenues) in fiscal 2017. The county's cash levels fall below the median of Aaa-rated counties (33.7% of revenues) nationally.

Debt and pensions: above-average debt burden, supported by independent utility funds, expected to increase given substantial capital improvement plans; low pension liability

While the county's debt burden is moderate, it will increase given additional plans for bond issues totaling nearly \$930 million between fiscal 2019 and 2024 to support capital projects. The county monitors bond authorization with a Spending Affordability Advisory Committee, and while the current capital budget anticipates between \$85 to \$105 annually for general capital projects and \$25 to \$50 million annually for utility projects, the committee recommends limiting annual issues to \$100 million, and internal county projections reflect additional bond issues closer to \$750 million over the next five years. The planned level of issuance will coincide with amortization of outstanding debt, affording the county some operating flexibility.

Additionally, further growth in the tax base will mitigate the effects of additional debt, as will moderate capital spending from pay-go funding totaling approximately \$70 million between fiscal 2019 and 2024, and the independence of the utility funds to support their portion of debt service.

Post-issuance, the direct debt burden will be \$1.4 billion, or 2.7% of 2018 full value, net of \$360 million of self-supported enterprise debt. Because the county also issues debt for its schools, its direct debt burden is elevated compared to peers. The median debt burden for similarly rated counties is approximately 0.7% of full value nationally, and 1.9% of full value in MD.

Debt service is paid through a combination of ad valorem taxes, user and connection fees, and special assessments. Debt service costs accounted for 9.7% of total fiscal 2018 operating expenditures.

The county maintains a \$1.9 billion six-year Capital Improvement Plan (2019-2024), with the majority of projects allocated for education, general county initiatives, and water, sewer, and storm drainage. The plan is financed through a variety of bonds, grants, state aid, and pay-go funding.

DEBT STRUCTURE

All of the county's debt is fixed rate. Amortization is average, with 60.3% of principal retired within 10 years.

DEBT-RELATED DERIVATIVES

The county is not party to any derivative agreements.

PENSIONS AND OPEB

The county maintains two single-employer defined benefit plans, for general government employees and for police and fire officers. The county contributed a total of \$38.9 million (3.7% of operating expenditures) to the plans in fiscal 2017. Both contributions represented 100% of the annual pension cost.

The county's combined adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$828.8 million in fiscal 2018, or a below-average 0.77 times operating revenues.

The county also provides other post-employment benefits (OPEB) to employees. In fiscal 2018, the county paid \$38.6 million towards the pay-go portion of these benefits and \$16 million to a trust to reduce the unfunded liability. The county anticipates a contribution of \$15.7 million in fiscal 2019 to reduce the unfunded liability. The county maintains an eight-year plan to increase its annual contribution

to meet the actuarially determined required contribution. Total fixed costs (pensions, OPEB and debt service) were a manageable 17.2% of fiscal 2018 expenditures.

Management and governance: strong oversight

By county charter, the general fund is required to maintain a budget stabilization reserve (committed fund balance) equal to a minimum 7% of audited prior year General Fund expenditures, a threshold the county has met in each of the last five fiscal years. Management also designates additional funds within the general fund balance for the two subsequent year's contribution to the budget stabilization reserve. The county is expected to meet its budget stabilization reserve policy going forward.

Maryland Counties have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures.

While the sector's largest revenue source, property taxes, is not subject to any statewide caps, income taxes account for approximately a third of revenues and are capped at 3.2%. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Maryland has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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